

P.A.-941 amended the definition of graphic arts machinery and equipment to mean "...printing, including ink jet printing, by one or more of the processes described in Groups 323110 through 323110...Groups 511110 through 511199...and Group 512230...of the North American Industry Classification System..." (This is a GIL).

November 8, 1999

Dear Mr. Xxxxx:

This letter is in response to your letter dated March 1, 1999. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

COMPANY hereinafter referred to as Lessee is investigating the Sales and Use Tax treatment of a lease transaction involving tangible personal property that will have a taxable situs in your state.

We hereby request a ruling to clarify the application of your state sales and use tax law with respect to the transaction and equipment use described below.

**Transaction Background:**

The equipment in question, Image Magic Picture Maker (a digital imaging system) was originally purchased by the Lessor for subsequent lease or rental. The Lessee entered into a 'True Lease' agreement with the Lessor. Title to the property will remain with the Lessor, the owner of the property for federal income tax purposes. The equipment lease is for 60 months under a master lease agreement. Under the lease provisions, the Lessee will remain responsible during the lease period for insurance, maintenance, risk of loss and pay either directly or reimbursable to Lessor all taxes related to the property except taxes based on net income of Lessor. At the end of the 60 months, the Lessee has the option (1) return the equipment to Lessor, (2) purchase the equipment for its fair market value or (3) renew the lease for an additional term at the fair market rental value.

**Equipment, Features and Use:**

The Image Maker Picture Maker (the Unit) will be installed on site in our retail store locations. The Unit is meant to be customer

friendly. A 'walk up' customer may require store assistance in the operation of the machine. After the customer finishes making all their prints, they would take them to the Camera/Photo Department counter to purchase.

Computer hardware and software drive the Digital Imaging Picture Maker, the customers can customize by grouping features together offering which we believe to be a value-added change. The machine produces or makes a digitized image print from the original photo without a negative. Transfers images from old, worn photos to an Enhancement Station for photo restoration via write-to-diskette feature, the original print is returned immediately to the consumer.

Picture Maker features reduce 'Red-eye'; create Border designs; bigger pictures from wallet size to 8x12; Zoom and Crop; capture digitally on Disk all from existing pictures (no negatives needed). Customers make reprints, enlargements, photo gifts and high-resolution digital files and images. Touch Screen Monitor requires minimal intervention at point of sale. Automatically converts odd-size originals into standard print size in seconds. Add photographic quality creative border designs. Incorporates transfer capability (T-shirts, Mugs, etc.). Displays images in three suggested frame sales screens. Networks to a 'printerless' Enhancement Station to enhance productivity by sharing a printer. Maximizes full job overlap that allows simultaneous image manipulation and printing. Provided option prints two different 5x7 images at one time. Again, the customer can group features together in selectable modes, allowing a choice of the array of services.

The Image Maker CopyPrint Station System includes Digital Monitor, Digital Processor with built-in CD-ROM and floppy disk drive, Digital Print Scanner and Digital Printer. System enhanced copyright protection, which detects Special Paper to help avoid copyright infringements.

The Lessee's primary business is operation of retail drug stores, but we believe that a sales/use tax exemption may qualify based on the type and/or process use of the equipment under Manufacturing, Industrial Processing or Printing statutes or other provisions existing in your state laws.

We respectfully request your review of the facts presented and situation described above. Also we would appreciate you furnishing us authority for your response (statute, regulation, rulings, opinions, etc.). We certainly appreciate your assistance in this matter. If you have any questions or need any additional information please call me at ####.

Illinois taxes the retail sale and use of tangible personal property under two separate but related statutes. The Retailers' Occupation Tax Act imposes a tax on Illinois retailers measured by a percentage of their gross receipts from sales for use or consumption. 35 ILCS 120/1 et seq. The Use Tax Act imposes a tax on purchasers by taxing the use of tangible personal property purchased from retailers. 35 ILCS 105/1 et seq.

#### LEASES

In Illinois, lessors of tangible personal property under a true lease, except for automobiles leased for terms of one year or less, are considered to be the end users of the property to be leased. See the enclosed copies of 86 Ill. Adm. Code Sections 130.220 and 130.2010. As the end users of tangible personal property located in Illinois, lessors incur Use Tax on the lessors' cost price of the property. Since lessors are considered the end users of the property and have paid the Use Tax, no Retailers' Occupation Tax is imposed upon the rental receipts and the lessees incur no Use Tax liability for the rental charges. In Illinois, a true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease.

The alternative to a true lease is a conditional sale. In Illinois, a conditional sale is usually characterized by a nominal purchase option at the close of the lease term. This type of transaction is considered a conditional sale at the outset of the transaction making all receipts subject to Retailers' Occupation Tax. See Section 130.2010. In this situation, lessors/retailers may give Certificates of Resale to their suppliers for tangible personal property transferred subject to a conditional sales agreement. The lessors/retailers owe Retailers' Occupation Tax on any installment payments when they are received by the lessors/retailers. The lessees/purchasers owe corresponding Use Tax on the amount of the installment payments that are collected by the lessors/retailers.

As stated above, lessees do not incur any tax liability in a true lease situation. However, it is not unusual for true leases to contain contractual provisions stating that the lessees will reimburse the lessors for their tax costs. However, this is not a matter of Illinois tax law but of private agreement between lessors and lessees.

#### PRODUCTS OF PHOTOPROCESSING

Please find enclosed a copy of 86 Ill. Adm. Code 130.2000 concerning Persons Engaged in the Printing, Graphic Arts or Related Occupations, and Their Suppliers. Photographers, film makers, and other servicemen are subject to Retailers' Occupation Tax on the photoprocessing component of their total service charge when they sell products of photoprocessing. Such products of photoprocessing include prints, photographic reproductions, and microfilm. In transactions in which products of photoprocessing are sold in conjunction with other services, if a charge for the photoprocessing component is not separately stated, tax is imposed on 50% of the entire selling price unless the sale is made by a professional photographer, in which case tax shall be imposed on 10% of the

entire selling price. Please note that the sale of digital imaging and printing is not a sale of products of photoprocessing. Please refer, rather to the following discussion of Service Occupation Tax for the tax treatment of this type of service.

#### SERVICE OCCUPATION TAX

Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred incident to sales of service. For your general information we are enclosing a copy of 86 Ill. Adm. Code 140.101 regarding sales of service and Service Occupation Tax.

The purchase of tangible personal property that is transferred to service customers may result in either Service Occupation Tax liability or Use Tax liability for the servicemen, depending upon which tax base the servicemen choose to calculate their liability. Servicemen may calculate their tax base in one of four ways: (1) separately stated selling price; (2) 50% of the entire bill; (3) Service Occupation Tax on cost price if they are registered de minimis servicemen; or, (4) Use Tax on cost price if the servicemen are de minimis and are not otherwise required to be registered under the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of sales of service. The tax is based on the separately stated selling price of the tangible personal property transferred.

Under a second method, if servicemen do not wish to separately state the selling price of the tangible personal property transferred, those servicemen must use 50% of the entire bill to their service customers as the tax base. Both of the above stated methods provide that in no event may the tax base be less than the cost price of the tangible personal property transferred. Under these methods, servicemen may provide their suppliers with Certificates of Resale when purchasing the tangible personal property to be transferred as a part of the sales of service.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). See, 86 Ill. Adm. Code 140.101(f) enclosed. This class of registered de minimis servicemen is authorized to pay Service Occupation Tax (which includes local taxes) based upon the cost price of tangible personal property transferred incident to sales of service. They remit the tax to the Department by filing returns and do not pay tax to suppliers. They provide suppliers with Certificates of Resale for the property transferred to service customers.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under the Retailers' Occupation Tax Act. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). Such de minimis servicemen may pay Use Tax to their suppliers or may self-assess and remit Use Tax to the Department when making purchases from unregistered out-of-State suppliers. Those servicemen are not authorized to collect "tax" from their service customers, nor are they liable for Service Occupation Tax.

#### MANUFACTURING MACHINERY AND EQUIPMENT

Machinery and equipment that are used primarily (over 50% of the time) in the manufacturing or assembling of tangible personal property for wholesale or retail sale or lease are exempt from Retailers' Occupation Tax. See the enclosed copy of 86 Ill. Adm. Code 130.330. The manufacturing process is the production of any article of tangible personal property, whether such article is a finished product or an article for use in the process of manufacturing or assembling a different article of tangible personal property, by procedures commonly regarded as manufacturing, processing, fabricating, or refining that changes some existing material or materials into a material with a different form, use, or name. These changes must result from the process in question and be substantial and significant. The manufacturing machinery and equipment exemption also extends to repair and replacement parts as long as the parts are incorporated into machinery and equipment that are exempt under the regulation. Supplies, such as consumables, do not qualify for the exemption. See subsection 130.330(c)(3).

Manufacturing includes photoprocessing if the products of photoprocessing are sold. However, as noted above, the sale of digital imaging and printing is not a sale of products of photoprocessing. Digital imaging and printing is not commonly regarded as manufacturing.

#### GRAPHIC ARTS EQUIPMENT

For your information, we have enclosed a copy of 86 Ill. Adm. Code 130.325, which are the Department's regulations for the Graphic Arts Machinery and Equipment Exemption. The Graphic Arts Machinery and Equipment Exemption extends to machinery and equipment that is used primarily in graphic arts production. Prior to recent legislation, "graphic arts production" meant printing by one or more of the common processes or graphic arts production services as those processes and services are defined in Major Group 27 of the U.S. Standard Industrial Classification Manual. Generally digital imaging and printing systems did not qualify for the exemption unless used in the production of manifold business forms or greeting cards.

However, Public Act 91-541 was signed into law on August 13, 1999. This measure amended the definition of "graphic arts production" to mean "printing,

including ink jet printing, by one or more of the processes described in Groups 323110 through 323122 of Subsector 323, Groups 511110 through 511199 of Subsector 511, and Group 512230 of Subsector 512 of the North American Industry Classification System published by the U.S. Office of Management and Budget, 1997 edition. Graphic arts production does not include (i) the transfer of images onto paper or other tangible personal property by means of photocopying or (ii) final printed products in electronic or audio form, including the production of software or audio-books." Groups 323114 and 323115 of the North American Industry Classification System include quick printing and digital printing processes. Equipment such as the Image Magic Picture Maker, which did not qualify for the graphic arts exemption prior to Public Act 91-541, can qualify for the graphic arts exemption under the new legislation.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at [www.revenue.state.il.us](http://www.revenue.state.il.us). If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Martha P. Mote  
Associate Counsel

MPM:msk  
Enc.